Cash Management

Bank trust divisions getting closer look

By Richard J. Gillespie

The cash management practices of bank trust departments are coming under new scrutiny.

• The comptroller of the currency is conducting a survey of such practices.

• A recent court ruling found Bank of America did not violate its fiduciary duty in the way it handled the cash balances of trust customers.

• Cash management in bank trust departments was the subject of a study published recently by bank consulting firm, Littlewood, Shain & Co. in Wayne, Pa.

(A spokeswoman for the comptroller's office said the survey was unrelated to the Bank of America case.)

"It seems to be that there is an awareness now of what is going on in the trust department," said David Bojanic, a banking analyst at Littlewood, Shain, citing the introduction of defined float policies at some institutions.

While corporate customers and employee benefit plans long might have had specific guidelines governing the bank's use of float on idle trust cash balances, personal trust clients generally have not had any kind of guidelines to work from, he said.

"That is not to say that there is anything wrong going on, because in the Bank of America case, the judge found both positive and negative float," he said.

More than 100 bankers got questionnaires from the comptroller's office earlier this month, asking them to document cash management practices.

Ellen Stockdale, deputy director of communications at the comptroller's office, explained the survey was not prompted by any suspicion of widespread abuses in the cash management practices of bank trust departments.

Ms. Stockdale said the comptroller did not expect the survey to turn up anything dramatic, but that the office had found in the past that banks had not always complied with regulations governing how they should handle cash awaiting investment.

"What we have found was not so much abuses, (but) mostly the kinds of difficulties you would expect — largely oversight and not in the sense of consistent practices," she said.

"We just decided it was worthwhile to survey some of our institutions to see if they had any difficulty understanding what we wanted them to do, or whether they had policies in place that were not sufficient to get them to comply with the regulations we made in 1982."

In July 1982, the comptroller's office issued a regulation requiring banks to invest all the cash from trust account principal and income in instruments that paid the maximum interest rate for short-term trust-type investments.

"What most of them do now is put them in money market deposit-type accounts, and the rates on SuperNow accounts are comparable," she said. She added that with the options available today, it no longer is acceptable for a bank to keep the money invested in a regular savings or NOW account, which pays only 5.25%.

"As long as there are not limitations on the trust that say cash can only be invested in Treasury securities, we expect cash to make a market rate of return," she said.

Also, she said the comptroller's office had not found any consistent pattern of problems where banks execute securities purchases and sales on behalf of trust clients, although she did say that in certain cases, money was found not to have been invested properly.

Survey results are not expected for several months because some of the questionnaire requires a considerable amount of "back work," she said; the answers to some questions require data going back to 1982.

In the recently concluded Bank of America case, Ted E. Van De Kamp vs. Bank of America, California Superior Court Judge Lester E. Olson found the bank did not breach its duty as trustee.

It took 190 hours of trial time, 4,810 pages of testimony and 1,439 exhibits to establish a record before the court could conclude the bank's cash management and float allocation practices were not wrongful to its beneficiaries.

Specifically, Bank of America engaged in three types of trust cash management practices that the plaintiffs alleged were wrongful.

• Bank of America had pooled and used idle trust account cash balances for its own benefit rather than that of beneficiaries, retaining

Continued on page 28

Short-term index to run in P&I Age

A new index to be published in *Pensions & Investment Age* will make it possible to judge the performance of short-term investment managers on a total return basis.

While bond and equity managers are judged partially on their ability to generate capital gains or protect clients against capital losses, their counterparts in short-term investment management only have had to beat yields.

This situation came about because most cash managers traditionally bought cash instruments to hold to maturity. As a rule, the only times cash investments were liquidated before maturity was when there was an urgent need to generate hard cash.

In many instances, a short-term investment manager's ability to produce returns is severely constrained by the corporation's demand for cash flow.

During the past few years, however, short-term investment management has evolved. Today, there exists a new breed of short-term investment manager who, like their counterparts in the bond and equity management industries, will take advantage of major market moves wherever possible.

Many short-term investment managers are given a portion of a portfolio and the responsibility to invest it for a short, but predetermined, time to maximize profits and protect the principal.

Like bond managers, they buy and sell instruments in order to exploit market discrepancies. Unlike many corporate cash managers, the short-term managers have no built-in desire to hold any particular security until maturity.

Because the short-term manager pits analytical skills against the vagaries of the market in the same manner that bond and equity managers do, it is appropriate that he or she be judged by the same standards.

In this and future editions, *P&I Age* will feature a performance measurement index for investment managers, and others, to help them evaluate short-term investment performance.

This index, actually a table of indexes, will be compiled by the Los Angeles firm Payden & Rygel, which specializes in short-to-intermediate-term investment management both for excess corporate funds and specialized pension fund management.

The Payden & Rygel index is intended to be a short-term investment benchmark and offers total returns on a variety of short-term instruments rather than the initial yields provided by other short-term investment tables.

Because it focuses on total returns, it can give corporate cash surplus managers a feel for the volatility of the short-term investment markets as well as for their ability to beat the market where they trade actively.

Payden & Rygel index of short maturity assets*

(For month ending March 31, 1985)

	Quarter Ending 12/31/84	March 1985	Quarter to date	Year to date	Yield level monthly change**
	Annualized total returns				
90 Day					
U.S. Treasury bill	11.52	9.79	8.24	8.24	–23
Domestic C.D.	11.83	9.70	8.29	8.29	–31
Eurodollar C.D.	12.29	10.14	8.39	8.39	–39
180 Day					
U.S. Treasury bill	14.22	10.96	8.28	8.28	–55
Domestic C.D.	14.46	11.94	7.82	7.82	–48
Eurodollar C.D.	14.53	12.36	8.22	8.22	–50
1 Year					
U.S. Treasury note	18.30	12.28	8.35	8.35	–23
2 Year					
U.S. Treasury note	25.72	15.55	7.30	7.30	–23

*Figures are annualized total returns. Quarter-to-date and year-to-date figures linked monthly. 90 and 180 Day Treasury bill yield level changes on discount basis.

**Basis points.

Source: Payden & Rygel, Los Angeles, Calif.

Consider the final quarter of 1984. The annual effective yield on 180-day Treasury bills was 11.06% Sept. 30, but a short-term investment manager who bought a 180-day T-bill for sale at year-end would have produced a total return more in the order of about 14.22% because interest rates declined during the period.

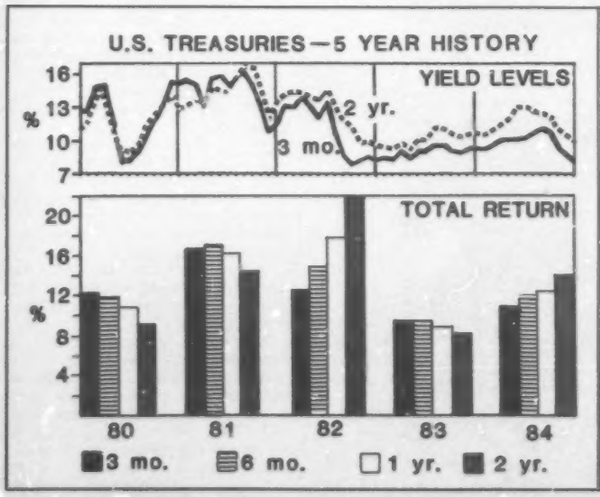
The total return the manager achieved will not exactly match the Payden & Rygel 180-day T-bill index for the period because the index is a constant maturity aggregate, constructed from the linked monthly returns.

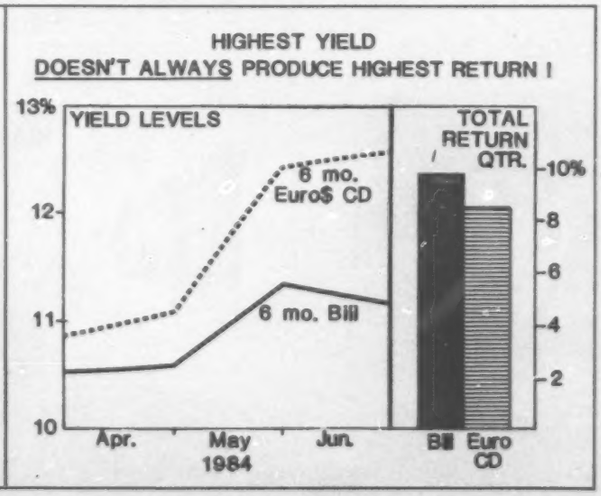
But it is a far more accurate indicator of the performance of a treasury portfolio with an average maturity of 180 days than a simple yield.

Likewise with the one-year Treasury note, a short-term investment manager purchasing this security Sept. 30 and liquidating it at year end would not have returned the 11.43% annual effective yield recorded Sept. 30, but a return more in the order of a whopping annualized 18.39%.

Most dramatic of all, had the manager bought the two-year Treasury note Sept. 30 and sold it at year end, he or she would not have produced the annual effective yield of 12.07%, but instead enjoyed a

Continued on page 30





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Short-term index . . .

Continued from page 27

total return around 25.72%.

The discrepancy between simple yields and total returns on Treasury and bank securities are plotted in the accompanying graphs, while the table indicates the total returns in most recent periods. The last column of the table shows the basis-point change in current yield during the period chosen.

At the same time, the Payden & Rygel Index provides a common denominator for measuring the return on a portfolio containing instruments of varying maturities.

If, for example, a money market fund portfolio had 10,000 different investments of maturities ranging from overnight to two years, by what yield should that portfolio be judged other than by other money market funds?

If the same portfolio had an average maturity of 90 days, then the Payden & Rygel 90-day Index would provide a yardstick for measuring the performance of the whole portfolio.

Another advantage of the Payden & Rygel Index of Short Maturity Assets is that it shows total returns on various cash instruments with a variety of different maturities, and therefore provides a comparable basis for measuring returns of short-maturity assets in relation to equities and long-term bonds.

The choice of U.S. Treasury instruments eliminates factors that might account for fluctuations in the value of other short-term instruments, such as a change in marketability or credit rating. Bank issues were included because they are widely held and represent domestic and Eurodollar markets.

The total rate of return of any short-term asset is determined by four factors: interest rates; the shape of the yield curve; the passage of time; and credit perceptions.

The Payden & Rygel Index eliminates the effect of "riding the yield curve" by assuming a constant maturity for each instrument on a monthly basis. The following is an example of the index methodology using the six-month T-bill.

To calculate the return for the six-month T-bill, the dollar price at the end of the previous month is used as a starting point. The yield of a six-month bill is derived from the month-end market price calculated through a formula that "shortens" the maturity by the number of days in that particular month.

The price of the bill at the previous month-end is subtracted from the derived price and the result is then divided by the price of last month's six-month bill to calculate a percent total return.

This process is repeated each month to produce a series of monthly returns that are chained together to provide quarterly, year-to-date and annual rates of return.

The Payden & Rygel Index of Short Maturity Assets will be run in each issue, but the information will be provided only on a monthly basis. ■

Practices . . .

Continued from page 28

In the Littlewood, Shain study, the firm found "float is a problem in every trust department of every size."

"Few trust departments perform any type of float analysis, and many do not currently have the necessary computer ability," the study said.

"Therefore, while the trust department is examining its internal work process float, it should simultaneously be updating its computer systems . . ."

"It is Littlewood, Shain's opinion that float allocation will become a requirement, although initially it probably will be in the form of an approximate allocation," the report continued.

"Regardless of the float allocation outcome, it is imperative that the trust department perform some type of float analysis for pricing and costing purposes."

In a subsequent interview, the writer of the report, Mr. Bojanic, said it is costly for a bank to install a computer system capable of allocating float interest on cash balances, and with smaller trust clients, the additional income received from self-pooling probably does not make it worthwhile.

"The bank's argument is they could pool the accounts, but for a computer to remember the reallocation process by which funds are transmitted back to the original account with interest, would be cost prohibitive for most trust departments," he said. ■

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Corporate Finance

Company takes the offensive

By Barry B. Burr

PALO ALTO, Calif. — Using an increasingly leveraged balance sheet, CooperVision Inc. is embarking on what analysts see as an aggressive acquisition program.

Last month, it raised $200 million by selling 8½% convertible debentures, priced at par (*Pensions & Investment Age*, March 18).

"The issue is large for the size of the company," said Jonathan M. Frank, senior industry analyst, Value Line Inc., New York.

The debentures lifted CooperVision's long-term debt to about $294 million from about $94 million at year end.

CooperVision's debt-to-capitalization ratio rose to about 61% from about 35% last year.

"I think they are very aggressive financially," said Ruth Alon, analyst, Montgomery Securities, San Francisco.

The two major rating firms, Standard & Poor's Corp. and Moody's Investors Service, rated the recent convertible issue BB– and Ba2, respectively, both speculative grades, partly because of CooperVision's highly leveraged balance sheet.

Despite the ratings, "There was a lot of interest in those bonds because of CooperVision's potential," said Mr. Frank.

Plus, CooperVision's issue hit the market at a time of generally rising stock prices and falling interest rates, said Robert V. Mahoney Jr., CooperVision's vice president and treasurer.

"It was a great opportunity for us to get some attractive financing," he said. "We obviously don't need the money for capital expansion. We plan to make acquisitions with it."

He said CooperVision will use about $70 million of the issue to pay off other debt, about $20 million for working capital, leaving the rest for acquisition.

CooperVision Inc. capital structure

Year	Total debt ($ millions)	Total debt/ capital
1985*	$ 260.0	61.0%
1984	86.2	35.2
1983**	34.3	19.8
1982	80.8	58.0
1981	62.8	57.7
1980	22.5	39.6

*CooperVision estimates.
**CooperVision went public in January of 1983.
Source: Standard & Poor's Corp. for data from 1980 to 1984.

"You have to assume an aggressive acquisition strategy," said Joseph E. Millsap, vice president, L.F. Rothschild Unterberg Towbin, San Francisco. "Frankly, this company is on a fast growth track."

Mr. Millsap said the debt issue provided CooperVision with a war chest for acquisitions.

"It's positioning itself for major growth," he added.

The Nestle Co. Inc. tried to acquire CooperVision after it was spun off into a separate company by Cooper Laboratories Inc. in 1983. But Mr. Millsap said the Justice Department stymied the deal.

He noted CooperVision's increasing leverage isn't a strategy to fend off other potential suitors.

"It's not a defensive move," he said. "In fact, it might make CooperVision more attractive, providing the money is spent on lucrative acquisitions."

Aside from acquisitions, Mr. Mahoney said CooperVision will spend about $13 million on capital projects in 1985, up slightly from the $12.9 million last year.

Its net income from continuing operations was $26.4 million last year, up from $20.1 million in 1983.

It generated $36.8 million in cash from operations last year, up from $27.2 million in 1983. ■

Zero-coupon convertibles

Issue might be a first

By Barry B. Burr

OAK BROOK, Ill. — Waste Management Inc. plans to raise $100 million through what might well be the first offering of zero-coupon convertible debt.

The company filed the offering of convertible subordinated debentures with the Securities and Exchange Commission at the beginning of the month.

The timing of the proposed issue coincides with a new accounting test over whether to treat zero-coupon convertibles as common stock equivalents for a company's earnings per share computation (*Pensions & Investment Age*, April 1). The Financial Accounting Standards Board decision to implement the test apparently opens the way for other issues.

Merrill Lynch Capital Markets, designer of the Waste Management zero-coupon convertibles, said it already is discussing similar issues with other companies.

Two other investment bankers, First Boston Corp. and Morgan Stanley & Co., also have been working on developing zero-coupon convertibles.

As soon as the SEC approves the registration statement, said Harold Gershowitz, senior vice president, Waste Management hopes to sell the convertibles around mid-April.

Mr. Gershowitz cited two reasons for Waste Management deciding to issue the zero-coupon convertibles.

For one, the company wants to reduce the large amount of variable-rate debt on its balance sheet. About 61% of its $489 million in long-term debt is variable rate.

For another, Waste Management hopes to capitalize on the popularity of zero-coupon Treasury securities for individual retirement accounts. It is marketing its new zero convertibles to the retail market.

Merrill Lynch designed the securities, called liquid yield option notes, or LYONs.

The issue has been in the works since late last year, said John J. Cull, Waste Management's controller. But the company held up the filing awaiting the FASB decision on accounting for zero-coupon convertibles.

The new FASB treatment allows for an effective yield test as opposed to a cash yield test in deciding whether convertibles are common stock equivalents. Convertibles, generally, are considered common stock equivalents if their yield is less than two-thirds the prevailing average double-A corporate bond yield.

Zero-coupon convertibles, because their yield accrues, might have been regarded as common stock equivalents under the previous cash yield test and thus subject earnings to dilution.

"Under the recent FASB rule, they are not considered stock equivalents," Mr. Cull said.

"That ruling was a key to our decision to issue the zeros now."

Trying to attract individual investors, he said Waste Management plans to offer the securities in units of $1,000 principal, expecting them to sell at $250 each, providing a yield to maturity of 9%. In all, Waste Management will have to pay back $400 million in principal and accrued interest in 2001 when the debentures mature.

"We're betting over the next 16 years that (9%) will be an attractive rate," Mr. Gershowitz said.

Investors receive only maturing principal, no periodic interest payments from coupons. The difference between the discount price and the face value represents the accruing interest.

To protect investors against market price declines, Mr. Gershowitz said the LYONs carry a put, allowing holders to sell the security back to Waste Management. Holders can put the zeros beginning in 1988 at a 6% accrued yield, rising to 9% in 1991.

"The put feature puts a floor under the (market) price should investors not choose to hold them to maturity," he said.

Mr. Gershowitz said the securities will convert at a price of 110% of the market price of Waste Management's common stock on the date of the their sale.

Although the 10% conversion premium appears low, Mr. Gershowitz doesn't expect holders to convert immediately should Waste Management's stock rise.

If they did, he notes, holders would give up the 9% annual yield for a stock now with a dividend yield of about 1.5%.

Merrill Lynch officials said Waste Management is the first to file to offer such securities.

Continued on page 77

Corporate notes

2 reasons, 1 result

The Chubb Corp., New York, and Travelers Corp., Hartford, Conn., both went to the market with similar issues of convertible exchangable preferred but for different reasons.

Because of its tax-loss status, Chubb chose to issue $150 million in convertible exchangeable preferred stock over more conventional convertibles.

The issue gives Chubb the option of exchanging the convertible preferred for convertible subordinated debentures after three years.

Glenn A. Montgomery, assistant vice president, said the choice of the exchangeable securities over other types of securities was tax motivated. He said Chubb hasn't had to pay corporate income taxes, hence the decision to issue the convertible preferred.

"If we pay taxes, it would make sense to exchange the preferred stock for convertible debentures," he said, adding Chubb could then take advantage of the deductibility of interest and thus lower its interest costs.

"Chubb hasn't paid taxes in two or three years," Mr. Montgomery said. He said the tax status was the result of losses in the property and casualty underwriting business.

Goldman, Sachs & Co., New York, was the lead underwriter.

The preferreds are exchangeable into the debentures, maturing in 2010, at Chubb's option on any dividend date after three years. The debt would carry the same $50 par value and 8½% coupon and the same convertible feature. The issue is convertible into 0.722 shares of common, or at a price of 69¼, a conversion premium of about 21%.

At Travelers, Nancy Reiss, assistant director-financial relations, said its $200 million in convertible exchangeable preferred had nothing to do with taxes.

Morgan Stanley & Co., New York, was the lead underwriter for the issue. The 8.32% issue sold at $50 par.

Travelers may not redeem the issue for two years. After three years, it can exchange the issue into convertible subordinated debentures with the same conversion privilege. It is convertible into 0.975 shares of common.

Ms. Reiss said Travelers issued the convertible exchange preferred to boost the equity on its balance sheet.

Western in market

LOS ANGELES — After selling

Continued on page 74

New issues volume (U.S.)
(Jan. 1 — March 31, 1985)

	Amount ($ millions)	Number of issues
Straight debt	$14,337.0	201
Convertible debt	1,397.5	26
Common stock	4,237.4	126
Preferred stock	500.0	7
Convertible preferred	544.8	8
Total financings	$21,016.7	368

Source: IDD Information Services.

Domestic issues lag foreign in 1st quarter

By Marci Baker

NEW YORK — Non-U.S. new-issues volume outstripped the volume of domestic offerings by almost $16 billion in the first quarter.

According to numbers released by IDD Information Services, offerings outside the United States totaled $37 billion in the first three months. At the same time, issuers came out with offerings in this country of just more than $21 billion.

Credit Suisse First Boston Ltd. led other underwriters in market share on the non-domestic front, while Salomon Brothers dominated in the United States.

The London-based Credit Suisse captured 11.4% of the overseas new-issues market, acting as lead manager on $4.2 billion, according to IDD. Merrill Lynch Capital Markets grabbed the No. 2 spot with a 6.8% market share, managing $2.5 billion in non-domestic financings. Salomon ranked third, managing $2.4 billion for a 6.5% market share.

Salomon, however, continued to hold its strong position for U.S.-based new-issues volume. The firm managed $5.2 billion in the United States for a 24.7% market share. First Boston Corp. followed with $4 billion or 19.2% of the market. Merrill Lynch placed third, managing $2.4 billion or 11.7% of the market.

One big shift in the first-quarter domestic lineup was Drexel Burnham Lambert Inc.'s slide to seventh place from second in 1984. Drexel underwrote just more than $1 billion in the first three months of this year.

Observers attributed the investment banker's drop in the rankings to a slowdown in junk bond financings. First-quarter volume for new high-yield issues was just less than $2 billion. That's down from $2.4 billion in the first quarter of 1984 and $6.6 billion in the fourth quarter of last year.

Overall, first-quarter volume for U.S. offerings increased 17.3% from the $17.9 billion generated during the same period in 1984. Still, the pace was slower than it was at year end; the latest figures represent a

Continued on page 76

Ten largest underwriters*
(Jan. 1 — March 31, 1985)

Domestic offerings	($ bil.)
Salomon Brothers	$5.19
First Boston	4.04
Merrill Lynch	2.45
Goldman, Sachs	2.22
Shearson Lehman	1.74
Morgan Stanley	1.26
Drexel Burnham	1.00
Kidder Peabody	0.73
Paine Webber	0.43
Prudential-Bache	0.32
Non-domestic offerings	
Credit Suisse First Boston	4.20
Merrill Lynch	2.50
Salomon Brothers	2.40
Union Bank of Switzerland	2.00
Deutsche Bank	1.80
Morgan Stanley	1.70
Daiwa Securities America	1.64
Morgan Guaranty Trust	1.56
Goldman, Sachs	1.55
Nomura Securities Intl.	1.40

* Full credit to lead manager.
Source: IDD Information Services

New domestic issues lag . . .

Continued from page 73

23% decline from $27.3 billion in offerings registered during the fourth quarter of last year.

Likewise, first-quarter straight debt volume declined about 35% from that reported during last year's final quarter. It was flat against first-quarter 1984 volume, according to IDD.

Straight debt volume reached $14.3 billion for the three-month period compared with $14 billion for the first quarter last year and $22.3 billion for the fourth quarter.

Salomon Brothers led in this category as well, managing just more than $4 billion, or 28% of that market. The firm was followed by First Boston and Goldman, Sachs & Co., which underwrote $3.7 billion and $1.7 billion respectively.

While new issues declined from the previous quarter in the debt arena, common stock volume rebounded from its poor showing in 1984.

At $4.2 billion, common stock offerings were at their highest level since the fourth quarter of 1983. First-quarter financings also jumped 86.6% from the $2.3 billion offered in 1984's first quarter and 65.1% from the $2.6 billion reported for the fourth quarter.

Merrill Lynch was the frontrunner with $1.1 billion or 26.6% of the market to its credit. Salomon, which managed $970 million, and Morgan Stanley & Co., which underwrote $417 million, placed second and third respectively.

Merrill and Salomon won their common stock positions in part through their lead manager roles in many of the quarter's largest equity deals.

Merrill was lead underwriter for Commonwealth Edison Co., which at $282 million was the largest equity offering of the quarter. It also managed Public Service Gas & Electric's $182 million stock offering. Meanwhile, Salomon managed the $200 million-plus stock offerings by Loews Corp. and Maxicare Health Plans.

Salomon also was the lead underwriter for EQK Partners' $174 million initial public offering — the largest IPO for the quarter. The investment banker's role in the deal put Salomon in the No. 2 spot behind Merrill Lynch in the IPO underwriting rankings.

Salomon underwrote $194 million in two IPO deals, while Merrill was credited with four deals totaling $362 million. Third-ranked E.F. Hutton underwrote $104 million in three IPOs.

In the IPO after-market performance rankings, D.H. Blair & Co. Inc. took top honors, followed by Drexel, according to IDD. First-quarter IPOs managed by Blair had an aggregate after-market performance of 39%. Drexel's IPOs gained 17.5% for the period.

IPO financings overall totaled just more than $1 billion for the first quarter, slightly more than the $943.5 million generated during the fourth quarter of 1984. Still, IPO financings were off from 1984's first-quarter volume of $1.2 billion.

In the convertible debt arena, first-quarter volume reached $1.4 billion. Volume was down 14.5% from the fourth-quarter total of $1.6 billion. However, it was 177% greater than the $504 million in convertible debt offerings generated during the first quarter of last year.

Drexel grabbed the largest share of the first-quarter convertible debt market. It underwrote $375 million or almost 27% of the total. Shearson Lehman Brothers Inc. was second with $270 million.

Goldman, Sachs, which lead-managed $225 million for the quarter, placed third.

The leading manager for straight preferred stock offerings was Shearson Lehman, while Morgan Stanley led in convertible preferred financings.

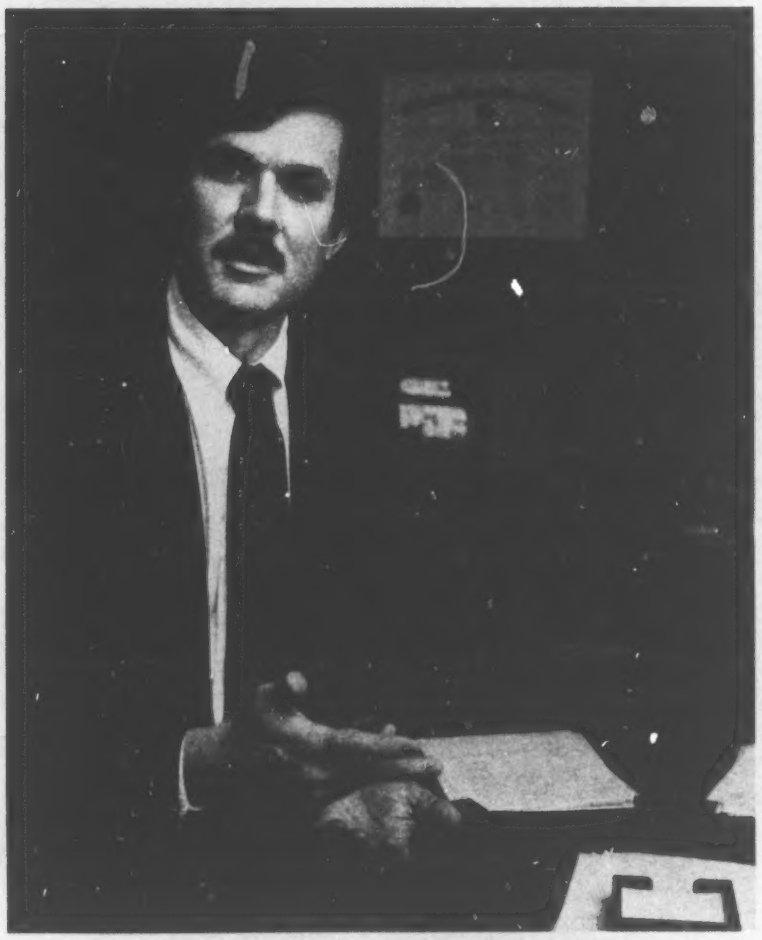
Shearson managed four of the seven preferred stock deals of the quarter, taking $275 million of the $500 million issued.

Morgan Stanley, however, won almost 37% of the convertible preferred market with only one $200 million deal, according to IDD. PaineWebber Inc., which underwrote four of the eight convertible preferred offerings of the quarter, placed second with $180 million credited to the firm.

Convertible preferred financings as a whole totaled $545 million for the quarter, their highest quarter level since the third quarter 1983. ■

"If there weren't S&P™ futures at the CME, we'd have to invent them."

—David Dunford
Senior Vice President and
Director of the Portfolio Group
Travelers Investment Management Co.
Hartford, Connecticut



David Dunford, who is responsible for portfolio management of $3 billion in pension funds, mutual funds and insurance-related portfolios at The Travelers, knows the necessity of managing risk in today's unpredictable equity marketplace.

"As a portfolio manager, it's my role to provide clients with maximum returns while operating within the boundaries of acceptable risk.

"S&P futures at the CME help me achieve that objective. I can reduce exposure to unintended market risk and manage stock market uncertainty, while helping to maximize returns for our clients.

"We especially favor the S&P 500 contract because of its tremendous liquidity and because it's based on an index that is very representative of the stock market as a whole.

"For portfolio managers, S&P futures are a valuable risk management tool. If there weren't S&P futures at the CME, we'd have to invent them."

To find out more about how David Dunford and others are using Standard & Poor's futures and options contracts at the Chicago Mercantile Exchange, ask your brokers for copies of "Inside S&P Futures" and "Inside Options on S&P 500 Futures." They can also show you videotapes featuring Louis Rukeyser that explain these important equity management tools. ■

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Convertibles bounce back

After a sluggish year, convertible debt issues have rebounded.

Analysts attribute the rise to a generally upward market and the increasing appeal of convertibles among investors looking for a less risky surrogate for common stock.

In the first quarter, there were 26 issues of convertible debt, totaling $1.4 billion, according to IDD Information Services Inc., New York.

The amount is more than double the 11 issues, totaling $504 million, in the same period last year.

Despite the rise, the latest quarter pales against the first quarter of 1983 when 31 issues, totaling $2.4 billion, were recorded.

In 1985, the convertible debt issues represent about 9% of all debt issued in the first quarter, according to IDD data.

By contrast, in the same period last year, convertible debt was about 3% of all debt issues; in the 1983 quarter, it represented about 17% of all debt issues.

Among recent issuers are Pep Boys-Manny Moe & Jack, $50 million; Cogenic Energy Systems Inc., $5 million; and Nordstrom Inc., $75 million.

"Across the board, there is a much greater awareness of convertible securities," said Mark Suvall, chief of the convertible department, First Boston Corp., New York. "There is more money going into convertibles and more demand, which allows issues to get a better deal.

"In general, the issues coming out this year have been priced aggressively," meaning favorable to the issuer.

Investors like convertibles as a means to participate in equity but dampening its volatility, Mr. Suvall added.

Referring to Nordstrom's issue, Bill Breitenstein, corporate controller of the Seattle-based company, said, "The market was right, especially for convertibles."

Nordstrom sold its convertible debentures, maturing in 2010, at par, yielding 7.5%. The issue converts at 46¼, for about a 24% conversion premium.

"We were very satisfied with the rate and the conversion premium," Mr. Breitenstein said.

First Boston, the lead underwriter, and Goldman, Sachs & Co., New York, handled the issue for Nordstrom.

Generally, issues of convertibles follow the general trend in the stock market, said Preston M. Harrington III, vice president of the fixed-income research department at Merrill Lynch Capital Markets, New York.

"The stock market was up sharply in the first month or so," he said. ■

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Pensions & Investment Age

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Federal termination policies challenged

By Joel Chernoff

WASHINGTON — The federal government's policy allowing employers to terminate their overfunded pension plans and continue similar retirement plans is in serious danger of collapsing.

The demise of the administration guidelines on asset reversions might be brought about by a court challenge by INTERCO Inc., St. Louis, Mo., which seeks to recover $3.5 million from a spinoff/termination that does not meet government standards.

If INTERCO succeeds in its lawsuit against the Pension Benefit Guaranty Corp., it would endanger employers' abilities to terminate pension plans and stay within the defined benefit universe.

Moreover, an adverse decision conceivably could cause the undoing of dozens of terminations effected since the administration guidelines were released in May 1984.

"The PBGC should have walked away from it," asserted Roger Thomas, pension counsel to the House Aging Committee. If the administration loses, the "house of cards may come tumbling down."

A court failure, though, would not be a surprise to the Reagan administration. Before the guidelines were issued nearly a year ago, agency officials had bitterly contested the validity of so-called spinoff/terminations.

Moreover, in the weeks before the guidelines were issued, officials at the Internal Revenue Service expressed grave concerns that certain portions of the guidelines would not survive a court challenge.

More recently, a senior Treasury Department official, responding to a request by Rep. Edward Roybal, D-Calif., chairman of the House Aging Committee, acknowledged that the guidelines do not have the force of law or regulation.

In addition, a separate challenge to a narrow aspect of the guidelines' rules on amortization of gains and losses by Celanese Corp. of New York adds more fuel to the fire, although Celanese is trying to work its problems out privately with the IRS.

"The Keystone Cops couldn't have done a better job than these guys," said one source, referring to the administration.

Not surprisingly, pressure again is mounting on Capitol Hill for legislation on the issue. The House Aging Committee and the Labor-Management Relations subcommittee will hold a joint hearing on overfunded plans, possibly in May.

"The Keystone Cops couldn't have done a better job" than the Reagan administration.

David Walker, the PBGC's acting executive director, now says the agency is considering shoring up the guidelines through new regulations, although he said that the guidelines had solid legal footing.

The guidelines, unveiled after nine months of haggling among the PBGC and the Departments of Labor and Treasury, were viewed as a fairly loose response to what critics had perceived as a growing rush by corporations to terminate overfunded defined benefit plans and recapture surplus assets.

In fact, a pension attorney who led an ad hoc group of lawyers seeking to allow the new techniques has remarked it was the first time he got more than he wanted from the government.

The guidelines allowed employers, under certain conditions, to terminate their overfunded pension plans and replace them with similar arrangements through so-called "termination/re-establishment" and "spinoff/termination" techniques.

In a spinoff/termination, a plan is split into separate plans for active employees and for retirees and deferred vested participants, with surplus assets allocated to the latter plan. The retiree plan then is terminated, with the excess assets reverting to the employer.

Continued on page 36

Stroh brews up shift in pension plan again

By Rose Darby

DETROIT — The Stroh Brewery Co., which terminated its defined benefit plan in 1983 and started a defined contribution plan in its place, now has converted back to a defined benefit plan, said David Stockman, manager of benefits.

From the outset, Mr. Stockman said, Stroh officials preferred to do a spinoff/termination and retain a defined benefit plan for active participants, but they had to wait until the Reagan administration altered its stance on the issue.

Mr. Stockman said the cost of terminating the original plan, starting the defined contribution plan, then changing it to a defined benefit plan, "ran in the hundreds of thousands of dollars."

After the company first complied with government regulations by doing a complete termination of its

Continued on page 37

Late news

California picks CIO

SACRAMENTO, Calif. — Tom Flannigan, deputy chief investment officer for the New York State Common Fund, was asked April 24 to become chief investment officer for the California State Teachers' Retirement System.

If he does accept, as is expected, he will be the first permanent chief investment officer for the $13 billion state teachers' system since Mel Petersen left more than two years ago. Rich-

Continued on page 2

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Partners' departures spur move

3 seek venture cap pullout

By Steve Hemmerick

SAN FRANCISCO — At least three major institutional investors are trying to withdraw their commitments as limited partners from a new venture capital fund.

Sources said the Michigan State Retirement System, the University of Pittsburgh endowment and Investment Advisors Inc., Minneapolis, are seeking withdrawal from the EAS Ventures fund, an $18 million fund with eight other limited partners.

In addition, the Ohio Police and Firemen's retirement system wants to reduce its commitment to the fund to $3 million from $5 million.

The withdrawal attempts were described by some venture capital experts as unheard of and very unusual. One said they could signal the start of a realignment of power in venture capital investment — with institutional investors taking a more active role.

Michigan is seeking a total withdrawal of its $5 million commitment, and the University of Pittsburgh and Investment Advisors, total withdrawal of their commitments of $1 million each.

The request for withdrawals came after two of four general partners, Elliot Steinberg and Chris Woodword, left the fund. Remaining general partners are Larry Nerheim, former head of the trust department at Bank of America, and the investment banking firm, European American Securities, Inc., of which Mr. Nerheim is chairman.

Following the split-up, some limited partners felt the fund had been damaged, according to sources, and as a consequence sought withdrawal. They agreed, during a meeting called by the limited partners, not to sue one another concerning any intended withdrawal from the partnership agreement.

But Mr. Nerheim, who was general counsel or chief lawyer to the Securities and Exchange Commission in the mid-1970s, said the partnership agreement makes no allowances for withdrawals before the end of the 10-year term of agreement. He said the agreement allows for changes in general partners, including resignations, without their having any effect on the venture fund.

He described the ongoing negotiations by some limited partners to withdraw from the fund as "mind boggling."

But he added, "Life is too short to do business with those who don't want to do business with you. I don't want to spend the rest of 1985 fighting fires."

Continued on page 37

2 public funds join in buy-out

By Steve Hemmerick

Two public pension funds have become about 60% owners of a chain of motels as participants in a leveraged buy-out they initially doubted would succeed.

The Washington State Investment Board invested $107.9 million and the Oregon Public Employees' Retirement Association, $40 million, to help take the chain of 55 Red Lion Motor Inns private.

At the time the pension funds' hoped-for buy-out first was revealed, John Hitchman, executive director of the Washington board, said "there is an excellent chance it will not go through" because of other offers for the motels (*Pensions & Investment Age*, Dec. 10).

The two public funds are limited partners in a buy-out engineered by general partners Kohlberg, Kravis, Roberts & Co., San Francisco. It is not known whether there are any other limited partners.

According to sources, the amount of money borrowed to finance the purchase of the inns was significantly lower than for many other buy-outs. No amount was given, however.

The buy-out supports Mr. Hitchman's contention two years ago that pension systems in the future would be buying companies.

The Washington board, which has about $5.5 billion in assets, has set aside $281 million for leveraged buy-outs, and the $4.5 billion Oregon system has set aside well over $100 million in recent years.

Kohlberg, Kravis will be involved somewhat in the management of the inns. The existing management will remain in place, and it is believed that Kohlberg, Kravis and Red Lion's management share in the equity ownership.

Mr. Hitchman described the current inn management as "spectacular."

Although this investment is small compared with the $10 billion in assets held by the two funds, both pension systems have been on a steady course of investing outside the stock and bond markets.

In 1983, for example, Oregon and Washington each committed $100 million to a new Kohlberg, Kravis leveraged buy-out fund. (The money used for the buy-out of the inns was not connected with that pool.)

Late last year, Washington com-

Continued on page 35